No. 14852

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

C. A. Swanson & Sons Poultry Company,

Appellant,

vs.

William A. Wylie, Trustee in Bankruptcy for the Manuel Delatorre dba R & M Egg Farms, Bankrupt,

Appellee.

APPELLANT'S REPLY BRIEF.

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Disputed Facts.

Since a case of this kind is largely decided on the evidence, each item adduced at the trial becomes important to the decision. On this theory is predicated the first portion of Appellee's Brief—labeled "Statement of Facts" —and for this reason does the appellant hereinafter call this Honorable Court's attention to various portions of the aforementioned Statement of Facts. Appellant will endeavor to maintain some semblance of continuity by referring point by point to the disputed portions as they appear in Appellant's Brief.

While it is doubtful whether or not the credit terms extended to the bankrupt prior to May 1, 1953, were on

the basis of 30 days, or two weeks, the appellee has placed some emphasis on the matter. Mr. Elmo Cross, assistant manager of the defendant supplier, and in charge of credit arrangements, clearly insisted that at all times up to about May 1, 1953, the credit extended to the bankrupt was on a two-week or 15 day basis. [Tr. 92.] Mr. Cross then testified that, in accordance with the customary practice of his company, and in line with the general practice, the bankrupt was put on a cash basis, when several checks were dishonored and the unpaid balance exceeded their predetermined credit ceiling, until such time as the bankrupt "got back on his feet." [Tr. 90, 100.]

Although the bankrupt testified that when he was called in to the office of the defendant in May, Mr. Cross said "things didn't look so good," the testimony of Cross refutes it. He stated that when the credit exceeded a certain amount, they put the defendant on a cash basis. Even the bankrupt stated that after May 1st, when the alleged statement was made, his credit was "cut down" but was not cut off until the chattel mortgage was given. It appears more than unlikely that the defendant would continue to extend credit after finding that "things didn't look so good." On the contrary, at the bottom of page 89 of the Transcript, after the defendant's representative had arranged for a chattel mortgage, we find the following: "We did not go through his books completely. We glanced through them to see what he owed other customers. We paged through his books, his accounts payable and they weren't too heavy and we went through the accounts receivable. I think at that time they were about $10,000 or $12,000. In our own minds after a rough sketch we figured his net worth if he had to liqui-

date would be $14,000 or $15,000 which convinced us that his mortgage was good."

Upon cross-examination Mr. Cross again said: "The day we looked through his books and took his inventory and started to make up the chattel mortgage we both made the statement that we were sure Manuel was in good shape—that he had had a little trouble before that." [Tr. 101.]

In appellee's statement of facts it is insisted that defendant refused to accept any more checks of bankrupt, and that defendant thereafter insisted on certified checks and cash; yet on cross-examination the bankrupt admitted that he had probably given the defendant ordinary checks. [Tr. 50.]

Argument.

It appears to be admitted by both parties to this cause that the controlling factor here is whether the defendant knew, or had reasonable cause to believe from the facts available to it, that the bankrupt was insolvent at the time the payments were made to defendant. The fact alone that the debtor actually was insolvent at the time, or that a preference actually resulted, is not sufficient grounds to recall those payments. The burden is on the trustee in bankruptcy to prove these points as facts, *Chicago Car Equipment Co. v. Buell,* 211 Fed. 638.

The trustee's claim to having sustained the burden of proof in this connection rests upon the following testimony only: (1) checks issued by the debtor to the defendant were being returned by the bank; (2) defendant in June of 1953 asked for and obtained a chattel mortgage from the bankrupt; (3) about May 1st of 1953, the

debtor was called in to the office of the defendant and, according to the testimony of the bankrupt, defendant's credit manager stated to him that "things don't look so good," and cut down defendant's credit to the bankrupt; (4) as early as November, 1952, the books of the bankrupt showed an insolvent condition, which did not change substantially thereafter; and (5) about June 1, 1953, Mr. Cross and Mr. Elliott, representatives of defendant creditor, had the bankrupt's books in front of them and should have seen the insolvent condition of the business. We will attempt in the following paragraphs to discuss the individual points.

(1) While the creditor here was concerned over the fact that checks were being returned by the bank, this concern was more as to the increase in the outstanding balance beyond their normal credit extension to the debtor, rather than a suspicion that he might not be able to pay. The appellant's office was concerned, but the bankrupt and his bank had ready and plausible explanations, and other circumstances such as credit reports, the continued increase in the bankrupt's volume of business, the constancy of his purchase of merchandise whether from the appellant or otherwise, militated against the appellant's acquiring any suspicion that the bankrupt was not telling the truth, and caused them to believe that he was solvent with a net worth of some $15,000.00, but was in the process of paying off the estate of his deceased partner, and was pressed for cash. [Tr. 90, 101.]

It is urged by appellee that the dishonoring of checks after the death of the bankrupt's partner should have caused the Swanson people to feel that the bankrupt's financial condition was bad, yet the record shows that even before the partner's death a check "bounced" now

and then. [Tr. 50, 57.] As stated above, these were explained away by plausible excuses, and the bankrupt would make prompt payments in between the bad periods.

One reasonable method of determining whether or not a creditor believes his debtor to be insolvent is to examine the relations between them. In the instant case, the record shows that for several months after checks were first returned, the appellant extended credit to the bankrupt, at least up to June 12, 1953, when they asked for and obtained the chattel mortgage. [Tr. 58.] It would be incongruous to believe that a creditor would extend further credit to a person, already substantially indebted to it, when there was reason to believe that the person was insolvent.

Appellee cites the case of *Eisnaugle v. Blank,* 125 Fed. Supp. 390, in support of his position, but an examination of that case reveals that although returned checks were likewise involved in that case, the creditor was possessed of other information which the Court held should have caused him to question the solvency of the bankrupt. The same applies in the case of *In re Talbot Canning Corp.,* 39 Fed. Supp. 858, cited by the appellee. In the latter case the evidence adduced the fact that prior to the payments there had been discussion between the debtor and creditor about the possibility of a receivership.

(2) We come now to the question of the chattel mortgage given to the appellant on June 12, 1953. Attention is respectfully called to the fact that as and when payments were thereafter received, the creditor did not credit them as payments on the mortgage, nor was the mortgage ever recorded. [Tr. 52.] The mortgage was only incidentally involved in this action, and it would seem

that the only reason appellee refers to it is to infer that at the time of its execution the creditor believed the bankrupt to be insolvent. When two or three checks were returned unpaid and the bankrupt's account with appellant exceeded a normal limit, appellant's agents requested the chattel mortgage. [Tr. 88-90.] Contrary to the contention of the Trustee in Bankruptcy, appellant's Mr. Cross and Mr. Elliott believed the bankrupt to be solvent and possessing a net worth of about $15,000. Furthermore, at the same time they informed their head office in Omaha that although they had extended too high a credit, they felt that "the risk was good—that is payment was prompt until the time of Mr. Bone's death. We figured the account was good." [Tr. 90.]

(3) This point raised by appellee, calling attention to the testimony by the bankrupt that in the early part of May, 1953, appellant's credit manager called in the bankrupt and cut down the credit terms, chronologically should come before the preceding item. The attention of the Court is called to the fact that this testimony, given by the bankrupt himself—obviously a biased witness—was directly contradicted by the testimony of Mr. Elmo Cross, credit manager of the appellant. Despite the fact, as testified by the bankrupt, that "things didn't look so good," he relates that they continued to give him credit for at least another month, when they stopped all credit and put him on a cash basis. Mr. Cross, on the other hand, testified that the bankrupt had always been on a two-week credit basis (not 30 days as claimed by bankrupt) and that this continued until the early part of June, 1953, when they put him on a cash basis until "he got back on his feet." At the time the appellant was checking with Dun & Bradstreet, with other suppliers

in the business and with the bankrupt's bank as to his status.

(4) Respondent trustee in bankruptcy also argues that as early as November, 1952, the bankrupt was insolvent to the tune of some $1,700, as testified to by an accountant. Yet throughout the testimony appears the fact, testified to on both sides, that up to the time of the death of the bankrupt's partner on March 29, 1953, the firm was prompt in its payments and had a good credit standing in the industry.

Mr. Raymond Creal, accountant for the bankrupt firm, testified that when he made up a statement as of the 29th of March, the date the partner died, he found that the liabilities exceeded the assets by more than $15,000. This same accountant, who continued on after the partner's death, presumably permitted the bankrupt to disseminate false information about his financial condition, because on April 10, 1953, Delatorre issued a signed statement to Dun & Bradstreet showing a net worth of $16,640.00. [Tr. 83.] It must be assumed that the statement was based upon the same audit which the witness Creel made for the bankrupt after Bone's death on March 29th. On July 3rd of the same year, the bankrupt reported to Dun & Bradstreet that he was doing a volume of $250,000 a year and that he had a net worth of some $16,000. [Tr. 84.]

Appellant's credit manager testified that upon the partner's death they discussed the situation with the bankrupt, and were informed by him that he was in a temporary bind for cash, that he would now be better off even though he was making as much as $1,000 per week and it would be a matter of 45 days until he had the entire

account cleaned up. [Tr. 73.] Furthermore, the bankrupt stated to Dun & Bradstreet, that he was purchasing the interest of the deceased partner for the sum of $4,000. Query, if the business was insolvent, why was it necessary to pay $4,000 to the widow of the deceased for her interest in a liability, and why was it permitted to give a statement to Dun & Bradstreet showing a net worth of $16,000 when the insolvency amounted to approximately that much?

(5) Finally, appellee points out that at the time of asking for the chattel mortgage, Mr. Cross and Mr. Elliott of the appellant company had available the books of the bankrupt, and could have seen the bankrupt's insolvent condition.

As previously pointed out in this brief, there were made available to these men only the accounts receivable and accounts payable, at which they glanced and from which they reached the conclusion that the bankrupt was solvent and had a net worth of approximately $15,000—which, singularly enough, was substantially the same report that the bankrupt gave to Dun & Bradstreet as of the same period. If the bankrupt actually was insolvent, it is only reasonable to assume that he made available to these men only such of his records as would reflect the condition which he wanted them to find, and which he wanted the trade in general to find. Great stress is placed by the appellee on the fact that Mr. Elliott, assistant credit manager of Swanson, was an accountant, yet it appears nowhere in the record that he made an audit of the bankrupt's books. On the contrary, the record shows that he was not employed as an accountant by the company—only as a credit manager.

Incidentally, appellee in his brief asks why Mr. Elliott was not produced at the time of trial, and must have overlooked the testimony which indicated that Mr. Elliott had been ill for a year and was confined in a sanitarium. [Tr. 88.]

Conclusion.

Appellant has already cited cases in its opening brief on the question of which circumstances constitute reasonable cause for a creditor to believe that his debtor is insolvent, and we believe that these authorities preclude a finding in this case that the appellant had reasonable cause to believe that the bankrupt was insolvent at the time the payments were received. Not only must the trustee show that the payments constituted a preference, but it must be shown that the creditor knew that a preference would result, *Chicago Car Equipment Co. v. Buell,* 211 Fed. 638. The record here indicates that appellant knew that the bankrupt was making payments to other creditors, that he was doing business as usual, and that there was no reason to believe him insolvent. We again cite *McDougal v. Central Union etc.,* 110 F. 2d 939, where the court said, "Although the bankrupt may act in bad faith and with a fraudulent purpose in mind, yet if the transferee is free of fraud and acts in good faith, and gives a present fair consideration in exchange for the transfer of property, the transaction cannot be set aside. Payment of an antecedent debt is a fair consideration." Not only was there an antecedent debt, but the appellant continued to deliver merchandise to the bankrupt until after at least a part of the alleged preferences were made. Some of the checks were given to replace other dishonored

checks which the bankrupt had given to the appellant in payment of "cash" deliveries of merchandise.

Appellant respectfully urges that the evidence before the trial court does not support a finding (1) that the alleged payments constituted preferences, there being only the vague and uncertain testimony of the bankrupt, some two years later, that not all of the creditors in the same class received the same proportionate share as the appellant (certainly not proper evidence), and (2) that the appellant knew, or had reasonable cause to believe, that a preference would result by its receipt of such payments.

Respectfully submitted,

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